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C O N F I D E N T I A L SECTION 01 OF 02 TAIPEI 002822

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SUBJECT: CHUNGHWA TELECOM POSTPONES PRIVATIZATION PLANS

REF: TAIPEI 2084

Classified By: AIT Director Douglas Paal, Reason 1.4 (b)

1. (U) Summary: Chairman Ho-chen Tan told a Chunghwa Telecom (CHT) shareholders meeting on June 21 that continued concerns over employee benefits would delay until August the planned privatization of CHT through the sale of 17% of CHT shares. However, Ho-chen insisted that CHT remains committed to privatization, in spite of the Legislative Yuan's (LY) passage of a resolution calling on the government to suspend the share sale. CHT union leaders are planning a general strike on July 1 across Taiwan and have been preparing to travel to the U.S. to protest during Chairman Ho-chen's upcoming roadshow. Industry insiders agree that the sale will go forward despite the union's protests. End Summary.

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CHT's Halting March Toward Privatization...
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2. (U) The Taiwan government announced in January that it would once again try to sell 15% of its shares of CHT as American Depositary Receipts (ADRs) on the New York Stock Exchange (NYSE) in the second quarter of 2005 and a further 2% on the Taiwan Stock Exchange (TAIEX). A similar plan in 2004 was postponed when CHT union members protested. This year, CHT has pressed forward with the plan, in spite of labor union protests. On May 24, CHT announced it had chosen Goldman Sachs, UBS, and Morgan-Stanley to jointly manage the ADR issuance. A few days later (5/27), the Legislative Yuan passed an opposition-sponsored resolution calling on the government to suspend the privatization of CHT due to concerns that the sale would benefit "certain conglomerates" allied with the government, generally assumed to be CHT's competitors in the telecom business. Opposition lawmakers also complained that the timing of the sale would not maximize revenues for the government.

3. (U) In spite of opposition from the LY, the CHT Board of Directors approved the ADR sales plan in a private meeting June 15. This prompted union members to clash with police outside the CHT shareholders meeting June 21. CHT Chairman Ho-chen said after the meeting that CHT needed to fulfill local and U.S. regulatory requirements before the share sale could proceed and that the process could take several weeks. However, most analysts believe the delay was a direct result of the union protests. Ho-chen vowed to take care of the issue of employee benefits before the ADRs were released for sale.

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...Still Going Forward
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4. (C) Analysts and government insiders agree that the CHT's privatization plan will go forward this time, even if delayed by several weeks. CHT's Senior Director of Planning Mark Lee told AIT that the LY resolution, while influential, was not binding and that the government was not likely to significantly alter its plans as a result. He noted that the LY had approved CHT's broad privatization plan in 2001 and that the market for telecom shares appears to be as strong as it has been for several years, potentially maximizing income for the government. CHT management continues to discuss labor concerns about job losses and changes to the pension plan, but there are some issues that are best resolved by government agencies, including the Council of Labor Affairs, and the union.

5. (C) Kao Kai-sheng, Deputy Director General of the Directorate General of Telecoms (DGT), agreed with Lee that CHT privatization would move ahead this summer. Kao confirmed that the LY resolution was advisory in nature and not legally binding, but said that the Executive Yuan (EY) was actively considering how best to respond to the LY's decision. In an unusual move, the EY announced June 23 that the LY resolution was not legally binding and that the sale of ADRs should continue. This is the first time we have seen the EY issue such a statement in response to an LY resolution. Kao also confirmed that CHT Chairman Ho-chen

would travel to the U.S. as scheduled in the first week of July for a "roadshow."

16. (C) Industry analysts from financial management firms CLSA and PriceWaterhouseCoopers are confident that the privatization plan will move forward, in spite of the LY announcement. PWC's Jason Wang noted that the shareholders meeting had postponed the dividend issuance date from July to mid-August, presumably to allow privatization to occur before the dividend was issued. Democratic Progressive Party legislator Phoenix Cheng agreed that CHT would go forward soon, noting that privatization was already too far along to be stopped. Cheng suggested that the LY resolution was just another example of the opposition parties strategy of seeking headlines and political advantage by opposing any government supported initiative.

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But CHT's Union not Giving Up
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17. (C) Union officials, however, are not going along quietly. Following a small demonstration in May and the clash between union members and police outside the CHT shareholders meeting on June 21, union officials announced they would file a lawsuit against CHT management and the Ministry of Transportation and Communications (MOTC), accusing the defendants of breaching the trust of the shareholders. The head of CHT's union, Simon Chang, said he hopes the lawsuit will raise concerns among potential buyers about CHT's corporate governance and labor relations. Chang told AIT that the union believes CHT should fix corporate governance problems and guarantee worker rights before selling shares. The union has announced plans for a July 1 strike.

18. (C) AIT's NIV section also reports several CHT union leaders, including Simon Chang, have recently applied for U.S. visas, citing plans to go to New York for "tourism" at the same time CHT Chairman Ho-chen is expected in New York. Chang denied reports that union leadership was planning protests in the U.S. to coincide with the CHT roadshow. However, he told AIT that the union, with assistance from the US Telecommunication Workers Union, will hold at least one anti-privatization themed press conference in New York while CHT Chairman Ho-chen is there. According to Chang, if the union can force CHT to delay until the next session of the LY (scheduled to begin September 1) political pressure could prevent CHT from issuing ADRs.

19. (C) Comment: With the sale of these shares, CHT will finally be privatized, fulfilling a commitment the Taiwan government made prior to WTO accession. The union knows this will be their last chance to negotiate with the government over CHT's labor package and doesn't want to let the opportunity slip by without extracting the best possible deal. Union members are undoubtedly inspired by the recent failure to privatize Changhwa Bank after a series of management concessions on pay, job security and retirement drove the share price down so low that the share issuance became economically unsound.

10 (C) Comment Continued: Despite the CHT union's opposition, most analysts agree the ADR issuance will take place, albeit slightly delayed. The practical impact on CHT operations of privatization is likely to be small. The government, through MOTC, will still retain control of CHT's Board of Directors. The Public Construction Commission and CHT assure us that CHT procurement will still be subject to the requirements of Taiwan's Government Procurement regulations. Analysts and CHT management believe CHT is unlikely to radically alter its business practices. Although CHT employees will no longer be considered civil servants, CHT spokesmen have insisted there will be no layoffs or pay cuts. The question of retirement benefits remains to be settled, but the new national pension law going into effect July 1 and CHT's desire to see privatization completed before the next LY session should inspire both sides to reach agreement. End Comment.
PAAL